Bank Regulation and Stability: Lesson Learned From the Indonesian Banking Sector

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ABSTRACT

The 1997 financial crisis had severe impact on Indonesian banking. In late 1997, 16 banks were insolvent and eventually closed (Margono, Sharma, & Melvin, 2010). Based on data from the World Bank, the economic growth declined sharply to -13.1% in 1998. Thus, to recover from the crisis, Indonesia's economy needed about 51% of its GDP. Furthermore, the subsequent global financial crisis in 2008 slowed the Indonesian economic growth from 6.3% in 2007 to 6.1% in 2007 (Bank Indonesia, 2008). Hence, to avoid the same experience, the central bank devoted a thoughtful effort to maintain bank stability, including adopting the Basel principle, where capital is one of the strictly regulated aspects. This study is motivated by the journey of the Indonesian banking sector to achieve and maintain bank stability under different business cycles, from a country suffering amid the Asian financial crisis to achieving above 1 trillion GDP in late 2017 (World Bank, 2018). It is a bank-based country that faces the phenomena of "too big to fail," "too important to fail" (Pangestu & Habir, 2002), and "too many to fail" (Brown & Din□, 2011).

Keywords: Bank Regulation, Bank Stability, Capital Regulation, Capital Requirement